

G-008/GR-92-400 ORDER REJECTING ACCOUNTING TREATMENT IN
COMPLIANCE FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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In the Matter of the Petition of
Minnegasco, a Division of Arkla,
Inc. for Authority to Increase
Rates for Natural Gas Service in
Minnesota

ISSUE DATE: December 29, 1993

DOCKET NO. G-008/GR-92-400

ORDER REJECTING ACCOUNTING
TREATMENT IN COMPLIANCE FILINGS

PROCEDURAL HISTORY

On July 2, 1992, Minnegasco filed a petition seeking a general rate increase in the above-captioned docket. The Commission accepted a proposed rate case test year of July 1, 1992, through June 30, 1993.

On August 11, 1992, the Commission issued its ORDER ALLOWING DEFERRED ACCOUNTING TREATMENT AND REQUIRING INFORMATION in In the Matter of a Request by Minnegasco for Approval of Deferred Accounting for Manufactured Gas Plant Site Investigation, Monitoring, and Remediation Costs, Docket No. G-008/M-91-1015. In that Order the Commission approved Minnegasco's deferred accounting treatment of its manufactured gas plant (MGP) cleanup costs, starting January 1, 1992.

On August 31, 1992, the Commission issued its ORDER SETTING INTERIM RATES in the rate case docket.

On September 22, 1992, the Commission issued its ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING in In the Matter of the Accounting and Ratemaking Effects of the Statement of Financial Accounting Standards No. 106, Docket No. U-999/CI-92-96. In that Order the Commission adopted Financial Accounting Standard (FAS) 106, which governs accounting for PBOPs, or "Post-retirement Benefits Other than Pensions." The Commission adopted FAS 106 for utility recordkeeping and ratemaking purposes. The Commission authorized Minnesota utilities to use deferred accounting to record PBOP costs for three years, or until the final Order in their next rate case. The Commission also forbade interim rate recovery of PBOP expenses.

On May 3, 1993, the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in the rate case. The Commission allowed Minnegasco recovery of, among other things, certain MGP cleanup costs.

On May 13, 1993, the Company filed a Motion to Implement Compliance Rates and Tariffs. In that Motion, Minnegasco requested approval of a proposed deferral of FAS 106 costs. Minnegasco subsequently withdrew the motion, because the Commission was again taking up the issue of FAS 106 cost recovery upon reconsideration of the rate case final Order.

In the rate case ORDER AFTER RECONSIDERATION on July 19, 1993, the Commission allowed Minnegasco recovery of FAS 106 costs.

Final rates went into effect on August 12, 1993.

During review of rate case compliance filings and subsequent discussions and correspondence with Minnegasco, Commission Staff became aware of Minnegasco's proposed accounting treatment of MGP and FAS 106 costs. Minnegasco proposed amortizing MGP costs beginning August 12, 1993, the date final rates went into effect, and amortizing CIP and rate case expenses beginning September 1, 1992, the date that interim rates went into effect. Minnegasco proposed deferring FAS 106 costs from January 1, 1993, the date allowed under the September 22, 1992, generic FAS 106 Order. Minnegasco did not propose amortizing the deferred FAS 106 costs at this time.

Consideration of the Company's accounting methods for FAS 106 costs and MGP costs was set for a Commission meeting on November 10, 1993.

On November 8, 1993, the Company filed a request for an extension of time in which to consider and respond to Commission Staff briefing papers.

On November 10, 1993, Minnegasco filed comments addressing the FAS 106 and MGP accounting issues. Minnegasco reiterated its request for a time extension.

The matter came before the Commission for consideration on November 10, 1993. At the meeting, representatives of the Company, the Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) provided oral comments. The RUD-OAG and the Department spoke in opposition to the Company's accounting proposals.

FINDINGS AND CONCLUSIONS

I. Minnegasco's Request for a Time Extension

Minnegasco requested a time extension in order to more fully consider Commission Staff's briefing papers and to prepare a response to them.

The Commission finds that a time extension is not necessary under these circumstances. Minnegasco's accounting methods have been the subject of intense discussion with Commission Staff for a period of several months. Minnegasco has complete knowledge of its own accounting system, the matter at issue here. The Commission will not grant Minnegasco its requested time extension.

II. The Deferral of FAS 106 Costs

A. Minnegasco's Position

Minnegasco submitted its initial rate case filing on July 2, 1992. At that time, the Commission had not yet met to consider changes in accounting standards for FAS 106. The timing of Minnegasco's filing meant that at the commencement of the rate case the Commission had not provided direction regarding accounting treatment of PBOPs or recovery of these costs in interim rates.

According to the Company, this history is the reason that it did not begin deferring FAS 106 costs but instead expensed these costs in the usual manner beginning January 1, 1993. It is also the reason that Minnegasco proposed recovery of the costs in rate case interim rates.

On September 1, 1992, the Commission issued its ORDER SETTING INTERIM RATES, which excluded PBOP costs. The Order reflected the Commission's generic FAS 106 decision, which had been articulated on August 20, 1992 (although the written order was not issued until September 22, 1992).

In the September 22, 1992, generic FAS 106 decision, the Commission authorized deferred accounting for FAS 106 costs:

The Commission authorizes Minnesota utilities to establish deferred accounting for the increased cost resulting from a change to SFAS 106 accounting, with the deferred balance subject to Commission general rate case review. Deferred accounting will be allowed for each utility for three years beginning January 1, 1993, or until the issue date of the Order setting final rates following a general rate case, whichever occurs first. Interim rate recovery will not be allowed during the deferred accounting period.

Citing the September 22 Order as authority, Minnegasco stated in rate case compliance filing correspondence and its November 10, 1993, comments that it was deferring its PBOP costs from January 1, 1993, through July 31, 1993. Deferral would terminate on the latter date because it was the end of the month in which the Commission's final rate case determination took place (the Commission's July 19, 1993 ORDER AFTER RECONSIDERATION).

Minnegasco stated that no separate authorization or approval by the Commission was necessary for deferral. Minnegasco argued that it is clearly a Minnesota utility, and thus is authorized to defer PBOP costs under the Commission's September 22, 1993 Order. According to Minnegasco, its accounting treatment is consistent with the Commission's past rate case and FAS 106 Orders.

B. Commission Action

At the time of the Commission's generic FAS 106 proceeding, nearly all utilities and the Commission were dealing for the first time with the significant effects of the 1990 FAS 106 accounting change. The Commission issued its September 22, 1992, generic FAS 106 Order to provide guidance for utilities regarding their recordkeeping and ratemaking use of the accounting standard. In the Order the Commission found for the first time

that it is reasonable for a utility to present its case for [PBOP] rate case recovery, including recovery of any transition obligation, by means of the SFAS 106 accounting method.

Order at pp. 4-5.

In the September 22, 1992, Order, the Commission emphasized that allowing FAS 106 accounting for PBOP costs was not tantamount to allowing recovery of the costs in rates. The costs must be examined in a rate case proceeding.

In order to recover in rates, a utility must show that [PBOP] costs, like any other utility expenditure, are prudent and reasonable when presented for rate case recovery.

Order at p. 5.

The Commission recognized that the significant financial effects of the new FAS 106 accounting changes might drive many Minnesota utilities into otherwise unwarranted rate case proceedings because of the necessity of recovering PBOP costs. The Commission therefore mitigated this effect of the accounting change by allowing deferred accounting¹ of FAS 106 costs.

¹ Deferred accounting is a departure from the normal ratemaking policy of matching items of profit and loss with the time at which they are actually experienced. It is also a departure from the Federal Energy Regulatory Commission's Uniform System of Accounts, which is followed by the Commission. Deferred accounting is restricted to certain defined issues in which it is allowed by statute or Commission action. An example is the Conservation Improvement Program tracker, in which deferred accounting treatment is allowed in order to protect utilities from harm pending review of the prudence and reasonableness of CIP costs.

As discussed previously, the change from pay-as-you-go accounting to the accrual method for [PBOPs] may raise utility revenue requirements. If utilities were required to recognize the difference in cost at once, the accounting change could force many utilities to file general rate cases in order to adjust their revenue requirements. The Commission will therefore allow utilities to defer the increased cost created by the change to SFAS 106 accounting. The Commission will limit the time for such deferred accounting for each utility to a period of three years beginning January 1, 1993, or until the issue date of the Order which sets final rates following a general rate case, whichever occurs first. This should allow the utilities sufficient flexibility, while limiting the time during which deferred accounting takes place without Commission review.

Order at p. 6.

Examined in their full context, the Commission's FAS 106 proceedings indicate that the Commission has approved utility use of FAS 106 accounting, that the prudence and reasonableness of FAS 106 costs must be examined in the context of a rate case, and that utilities are allowed deferred accounting so that they will not be harmed pending examination of the FAS 106 costs in a rate case. The Commission clearly intended that the rate case proceeding in which final rates are determined (or three years, if it comes sooner) would be the outer limit for Commission review of the deferred costs. Just as with any other rate case item, Commission review of FAS 106 costs would of necessity include a determination of the recovery of those costs. That is the essence of rate case review.

The Commission finds that Minnegasco has not conformed to the Commission's requirements for FAS 106 deferred accounting in this proceeding. During the rate case proceeding, the only reference Minnegasco made to FAS 106 deferral was a May 13, 1993 motion requesting deferral; this motion was subsequently withdrawn. Through the determination of final rates upon reconsideration, the Company made no filing or representation which indicated that it was deferring or planned to defer FAS 106 costs. Indeed, the Company's own Exhibit 72 showed the Company expensing a full 1993 calendar year of PBOP costs, in the normal utility accounting fashion. Neither did the Company provide any information regarding proposed recovery (through amortization) of deferred costs. The facts of deferred accounting and recovery of deferred costs were not made available to the Commission during the pendency of the rate case, as required under normal rate case standards and under the Commission's generic FAS 106 Order. The Commission will not approve Minnegasco's deferred accounting of PBOP expenses.

The Commission notes that Minnegasco will not be harmed by this Commission decision. In this rate case the Company did not need the special protection of deferred accounting afforded under some circumstances through the generic FAS 106 Order. The rate case

was filed July 2, 1992; the test year was from July 1, 1992, to June 30, 1993. The final Order was issued on May 3, 1993, and the ORDER AFTER RECONSIDERATION was filed July 19, 1993. If approved, FAS 106 deferral would be allowed from January 1, 1993, through the final rate determination on July 19, 1993. In the May 3, 1993, final Order and the July 19, 1993, ORDER AFTER RECONSIDERATION, the Company was allowed the full test year (adjusted for known and measurable changes) of FAS 106 expenses. Minnegasco therefore did not need the special protection of deferred accounting to be kept whole throughout these proceedings. The normal rate case accounting method of expensing FAS 106 costs was sufficient to allow for the setting of just and reasonable rates.

The Commission also notes that allowing Minnegasco to defer FAS 106 costs which were eventually fully recovered in final rates would result in double recovery for Minnegasco (unless the Company refunded interim revenues that recovered FAS 106 costs). As discussed previously, deferred accounting is a departure from normal accounting practices. It has the effect of converting a cost item which would typically be expensed into a regulatory asset which will be eligible for possible future recovery. A utility which deferred an item such as FAS 106 costs during a rate case, then received full recovery in the final rate determination, should not expect to recover the costs during the interim period without a commensurate refund to ratepayers.

The Commission will not grant Minnegasco deferred accounting of FAS 106 costs.

III. MGP Cleanup Costs

A. Minnegasco's Position

In the Commission's August 11, 1992, ORDER ALLOWING DEFERRED ACCOUNTING TREATMENT AND REQUIRING INFORMATION, the Company was allowed to defer MGP cleanup costs starting January 1, 1992. Questions of amortization and recovery were not answered in the August 11, 1992, Order.

This Order does not decide how these expenses will be amortized or whether some or all of these expenses will be recovered from the Company's ratepayers. By approving deferred accounting treatment for costs incurred beginning January 1, 1992, however, the Commission is permitted consideration of those questions in Minnegasco's general rate case, Docket No. G-008/GR-92-400.

Order at p. 9.

MGP cleanup costs were disallowed in the ORDER SETTING INTERIM RATES, and were eventually allowed in the rate case final Order.

In post-rate case correspondence and its November 10, 1993, comments, Minnegasco stated for the first time that it intended to begin amortizing MGP deferred costs as of August 12, 1993, the date that final rates went into effect. Minnegasco's main point was that recognition of costs should coincide with their recovery in rates. Minnegasco maintained that it had not begun recovering MGP costs until final rates went into effect, because the costs had been specifically disallowed in interim rates. The Company quoted the ORDER SETTING INTERIM RATES at p. 4:

The Commission finds that manufactured gas plant cleanup costs should be disallowed in interim rates... If the costs are examined and eventually found recoverable in rates, the Commission may authorize the start of amortization.

Minnegasco stated that the rate case Stipulation accepted by the Commission reflected Minnegasco's theory of amortization for MGP costs. The Stipulation stated that "the Company received no interim rate recovery for MGP costs." Stipulation at p. 12. The document was silent as to when amortization would begin. Minnegasco argued that the amortization of MGP costs could not begin until after the rate case final Order, because the Stipulation could only be put into effect at that time.

Minnegasco argued that its position on amortization was supported by a Minnesota appellate decision, In the Matter of the Petition of Minnesota Power & Light Company, dba Minnesota Power, for Authority to Change Its Schedule of Rates for Electric Utility Service Within the State of Minnesota, 435 N.W.2d 550 (Minn. App. 1989). In that decision, the utility had requested separate and full Commission determinations regarding interim rates and final rates, based upon separate cost studies. The Commission refused to make two separate determinations, eventually ordering an ex parte interim rate increase and a final rate decrease based upon a full record, including cost studies. Upon appeal the utility asked that the required refund be reduced to reflect the higher costs which had occurred during the interim period. The Court of Appeals affirmed the Commission's decision and refused to adjust interim rates retroactively.

According to Minnegasco, the Minnesota Power & Light case indicates that Minn. Stat. § 216B.16 does not allow an after-the-fact comparison of specific expense items when final rates are compared to interim rates. The Company therefore argued that the fact that MGP costs were allowed in final rates does not mean that those costs were recovered in interim rates.

B. Commission Action

1. The Company's Interim Rate Argument

The Commission is unpersuaded by Minnegasco's main argument that it must be allowed to amortize MGP costs from August 12, 1993, when final rates went into effect, because it had been denied recovery prior to that time in interim rates. The Commission

finds that this argument is contrary to the statutory rate case scheme and to case law.

The public utility rate case statute, Minn. Stat. § 216B.16, contemplates the necessity of a complex general rate case proceeding to determine just and reasonable rates. The statute allows ten months in which the necessary investigations, discovery, and often full evidentiary hearings are held.

The interim rate provision of Minn. Stat. § 216B.16 is designed to keep utilities from financial harm due to the regulatory lag in rate case proceedings. Interim rates are set on an ex parte basis, without a full record, substantive Commission review, or the possibility of appeal. The statute therefore provides a formula to calculate interim rates. Absent exigent circumstances, interim rates are calculated using the proposed test year cost of capital, rate base, and expenses. Rate of return on common equity, the types of rate base and expense items, and rate design are tied to the utility's previous rate case proceeding.

The statutory interim rate scheme means that there is no Commission determination of actual utility revenue requirement at the time of setting interim rates. The formula is meant to stand as a temporary proxy for eventual Commission scrutiny, and to protect utilities from financial harm in the meantime.

At the time of the Commission's final rate case decision, the utility's revenue requirement is determined. This is the level that is applied in the rate case, and the interim rate formula is superseded. If the revenue requirement would have resulted in lower rates than those set in the interim period, an adjustment is required under Minn. Stat. § 216B.16, subd. 3.

If, at the time of its final determination, the Commission finds that the interim rates are in excess of the rates in the final determination, the Commission shall order the utility to refund the excess amount collected under the interim rate schedule, including interest on it which shall be at the rate of interest determined by the Commission.

The Minnesota rate case statute thus clearly contemplates a final determination of revenue requirement and rates which is applied retroactively to the point at which rates had first been adjusted on an interim basis. The case cited by Minnegasco, Minnesota Power & Light Company, supports this concept.

The interim period has never been interpreted in the past as creating a substantive period for calculating rates. Rather, the purpose of the interim period is to prevent the "potentially confiscatory effect of regulatory delay."
(Cite omitted.)

Minnesota Power & Light at p. 556.

To require the Commission to consider a separate cost study for interim rates would set dangerous precedent. The Commission has never been required to consider two cost studies in the past; final interim rate figures have always been calculated using final proposed rates established pursuant to data from the test year.

Minnesota Power & Light at p. 557.

The governing statute, logic, and case law all point to the conclusion that the Commission sets a rate case revenue requirement as part of its final determination, and applies that revenue requirement throughout the period of time in which rates are determined under the rate proceeding. Minnegasco has therefore recovered its MGP cleanup costs, through the interim rate period and beyond, by means of the final rate determination. The fact that MGP costs were not specifically included in interim rates does not contradict this finding. The costs were simply excluded under the rate case interim rate formula, because they were new costs which the Commission had not scrutinized in previous rate proceedings. The fact that the Commission did not specifically use these costs to set the interim rates level does not persuade the Commission that amortization of these costs should not commence until final rates are in effect.

2. The Company's Intent to Amortize, as Indicated by the Parties' Stipulation and Company Testimony

Since recovery or nonrecovery of MGP costs in interim rates does not control the amortization of those costs, the question remains as to when amortization should properly begin. The Commission finds that in this rate case the parties, including Minnegasco, understood that amortization would begin with the start of the test year. This fact is evident in the Company's rate case testimony and in the Stipulation agreed to by the parties and accepted by the Commission.

In Minnegasco's original filed rate case testimony, the Company proposed recovering approximately \$5 million of MGP costs, including \$1.1 million of amortization during the test year. In the Stipulation, the proposed \$1.1 million test year amortization was changed to \$500,000.

At p. 12 of the Stipulation, the parties state that "This results in a total test year expenditure (including amortization) of \$3,600,000. Exhibit A, Schedule 21 of the Stipulation shows the \$500,000 as a test year amortization amount.

Clearly, the rate case testimony and Stipulation contemplate amortization of MGP costs commencing with the start of the test year. No other proposal was made until the Company's post-rate case compliance filings. The Company's amortization should remain consistent with the filings that were relied upon in setting rates in this proceeding.

The Commission is aware that amortization commencing with the start of the test year, July 1, 1992, will result in a period of time (July 1, 1992, through December 31, 1992, the end of MGP

cost deferral) in which costs were simultaneously deferred and amortized. While this situation is unusual, there is no accounting principle which would be compromised under this scenario. Because deferred accounting is allowed infrequently in utility ratemaking, this accounting anomaly should also arise infrequently.

The Commission will require Minnegasco to amortize MGP cleanup costs commencing July 1, 1992.

IV. Rate Case Expenses and CIP Expenses

A. Minnegasco's Position

Rate case expenses and CIP expenses were included in interim rates. The Company therefore began amortizing these expenses on September 1, 1992, the date that interim rates went into effect. According to Minnegasco, amortization must coincide with recovery through rates. Since the Company was recovering in interim rates, it should amortize the expenses then.

B. Commission Action

The Commission finds that the Company should have begun amortizing rate case and CIP expenses on July 1, 1992, the start of the Company's test year. The record shows that these costs were built into rates by inclusion as test year expenses. Exhibit A, pp. 4 and 8-9 and Schedules 14 and 16 show the Company's intent to amortize the CIP tracker balance in the test year period. Exhibit A, p. 4 and Schedule 15 show the Company's intent to amortize rate case expenses through the test year.

The Commission will require Minnegasco to comply with the terms of the Stipulation and begin amortization of rate case and CIP expenses as of July 1, 1992.

ORDER

1. The Commission denies Minnegasco's proposal to defer FAS 106 costs.
2. The Commission requires Minnegasco to begin amortization of MGP cleanup costs, rate case expenses and CIP expenses as of July 1, 1992.
3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)